

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

130 2 6 1996

In the Matter of

Implementation of the
Telecommunications Act of 1996;

Accounting Safeguards Under the
Telecommunications Act of 1996

)
)
)
)
)
)
)

CC Docket No. 96-150

DOCKET FILE COPY ORIGINAL

COMMENTS OF LDDS WORLDCOM

Catherine R. Sloan
Richard L. Fruchterman
Richard S. Whitt

WORLDCOM, INC.
d/b/a LDDS WorldCom
1120 Connecticut Avenue, N.W.
Suite 400
Washington, D.C. 20036
(202) 776-1550

Its Attorneys

August 26, 1996

No. of Copies rec'd
List ABCDE

0411

SUMMARY

This proceeding, in close conjunction with CC Docket No. 96-149, is intended to adopt clear, strong, and comprehensive rules to implement Congress' intent that ratepayers and competitors be fully protected from unlawful cost-shifting and discrimination as the RBOCs begin to enter currently-competitive markets such as long distance service. WorldCom urges the Commission to view its twin safeguards proceedings as the only real opportunity to codify the language and intent of the 1996 Act in strict and readily-enforceable terms. In particular, a firm understanding of the source of the RBOCs' market power -- their control over local exchange and exchange access bottlenecks -- is vital to the proper fashioning of safeguards designed to curb the discriminatory exercise of that power. WorldCom offers several principles, drawn from market realities, that should guide the Commission as it fashions its safeguards:

- competitors' dependence on RBOC networks is increasing;
- RBOC discrimination in either exchange access or local service inputs can prevent competition in all telecommunications services;
- new local networks will not reduce RBOC market power anytime soon; and
- deregulation of RBOC pricing is premature while safeguards are still untested and RBOC incentives and ability to discriminate are increasing.

These principles lead to the conclusion that strong structural and accounting safeguards must be put in place to protect consumers from RBOC cross-subsidization and supracompetitive pricing, as well as to prevent discrimination in the pricing and provisioning of inputs required by the RBOCs' local and long distance service competitors.

General

WorldCom disputes several unsupported notions that appear in certain places in the Notice. First, the Commission's stated desire to preserve the RBOCs' ability to wield their

so-called "economies of scope" in the market is not supported by the Act, and is directly contradicted by the Commission's conclusion in the Local Interconnection Order that these very same aspects of monopoly must be shared with new entrants. Second, the Commission's apparent concern about minimizing the burden of its rules on the RBOCs is also not found in the Act, and must in any case be outweighed by the explicit requirements of the Act itself. Finally, the Notice's proposal that parties urging a stronger set of accounting safeguards must bear a "heavy burden" of persuasion is plainly wrong and should not be adopted.

The RBOCs' Integrated Out-of-Region and Incidental InterLATA Operations

WorldCom agrees with the Notice's focus on what safeguards should apply to the RBOCs' integrated out-of-region and incidental interLATA service operations. It would be premature at this time to address the wholly separate issue of what conditions to impose on the RBOCs' in-region operations once the statutorily-mandated separate subsidiary requirement has been eliminated at least three or more years down the road.

WorldCom strongly supports the application of the FCC's cost allocation rules, including the Uniform System of Accounts, to the dominant RBOCs. In particular, the RBOCs must be required to apply the USOA to their integrated provision of out-of-region interLATA services and local exchange and access services. In order to help minimize the possibility that an RBOC could improperly shift the costs of its interexchange operations to its local exchange and exchange access ratepayers, the RBOCs must allocate out-of-region interLATA service costs to a wholly separate account within the nonregulated category for accounting purposes only. The Commission should apply those same cost allocation requirements to the RBOCs' provision of incidental services.

WorldCom agrees with the Commission's suggested means of imputing the RBOCs' access charge revenues by recording them as expenses directly assigned to the RBOCs' nonregulated activities, with a corresponding credit to the regulated exchange access revenue account. However, much more must be done to ensure that the retail rates the RBOCs will charge to consumers are not artificially set below the actual cost of providing long distance service, including access. The Commission also must take several steps to ensure that the access imputation rule itself is fully enforced, including adding it as an item to be examined in the independent audit process.

In order to implement Section 272(e)(4) of the Act, the Commission should adopt a cost allocation rule that requires the RBOCs, where they provide services and facilities on an integrated basis, to provide those same inputs to their own internal operations only at the same rates and terms that they are made available to all other carriers. Where the RBOCs charge different rates for these inputs for different unaffiliated carriers, the highest rate must be paid by the RBOCs' integrated operations.

Finally, WorldCom agrees with the Commission's tentative conclusion that the 1996 Act gives it jurisdiction over all interLATA services, both interstate and intrastate. Consistent national rules are necessary with respect to the accounting safeguards that are applicable to the RBOCs.

The RBOCs' Separate Affiliates

While WorldCom welcomes the proposed strengthening of the FCC's affiliate transaction rules, the Notice appears to place too much emphasis on any additional implementation costs that the RBOCs might incur. Nonetheless, WorldCom agrees

wholeheartedly with the Commission's suggestion that the adoption of strengthened safeguards is in the public interest.

In its comments in CC Docket No. 96-149, WorldCom urged the Commission to enforce the Act's separation requirements by making the RBOCs' interLATA affiliate the basic retail entity for one-stop package offerings that include local and long distance service. This separate affiliate could offer interLATA service in competition with other entities by buying exchange access from the operating company, and also offer local service by purchasing local service elements and wholesale services from the operating company. WorldCom demonstrated how this structure will foster the Act's mandate for full separation of the RBOCs' in-region interLATA services, while still permitting full-service retail competition to proceed.

All RBOC accounting related to affiliate transactions must comply with generally accepted accounting principles. Among other things, GAAP will assist the RBOCs and the Commission to make sure that all transactions comply with the statutorily-mandated degree of separation. As is the case with the RBOCs' integrated operations, WorldCom also urges the Commission to require the RBOCs' separate affiliates to abide by the Uniform System of Accounts to enable a more accurate tracking of the way the RBOCs provide their services.

Consistent with the broad and deep separation called for in the Act, an RBOC is not allowed to offer combined packages of local and interLATA services through the joint efforts of its local exchange company and interLATA affiliate. Instead, as WorldCom explained in its comments in CC Docket No. 96-149, an RBOC can provide bundled or jointly-marketed offerings of local and interLATA services only (1) through the interLATA affiliate, (2) with the interLATA affiliate obtaining the local exchange components on the same basis as its

competitors. Such a structure is the only practical way that each of the interrelated protections mandated by Section 272 lead to separate and independent local and long distance operations.

In terms of how the RBOC relates to its affiliate, obviously the prices established should fully compensate the other party. In order that this mandate can be verified, the transaction should be recorded in writing by the parties in an auditable form. Each transaction should be made available for public review and inspection.

WorldCom supports the Commission's proposal to adopt identical valuation methods for assets and services which require that the RBOC seller charge either the tariffed rate or the higher of cost or estimated fair market value, and the RBOC buyer pay the lower of cost or estimated FMV. WorldCom believes that this new methodology will help reduce the economic incentives to underprice those RBOC services sold to affiliates, and to overprice the services the RBOC receives from the affiliate. However, WorldCom opposes the Commission's proposal to allow the RBOCs to establish their own "good faith" determination of FMV because it will lead to inconsistent and confusing results that will only give the RBOCs significant leeway to shift costs and discriminate. Instead, a uniform set of requirements for FMV should be established by the Commission and then applied to all the RBOCs across-the-board.

WorldCom agrees that the FCC's current affiliate transaction rules should apply to the RBOCs' transactions with their affiliates. Moreover, additional measures should be adopted. For instance, the Commission should adopt special valuation methodologies that will recognize the regulated status of the affiliates on both sides of the transactions. In addition, the Commission should apply its cost allocation rules to prevent subsidization of information services and other nonregulated activities by telecommunications services. Both measures would heighten

the protection of ratepayers and competition that is at the heart of the Section 271 and 272 requirements. Moreover, as WorldCom also urged in CC Docket No. 96-149, the Commission should require the RBOCs to report their earnings for each affiliate covered by Section 272 and for the operating company, so that the Commission can evaluate whether the RBOC is taking advantage of its ability to hide discriminatory pricing by moving its profit centers to the operating company.

WorldCom supports the Commission's proposal to apply its modified affiliate transaction rules to transactions between each RBOC and any interLATA telecommunications services affiliate it establishes. Where the potential for cross-subsidies exists, the Commission must adopt and enforce rules to limit the potential for harm to ratepayers and competition.

LEC Price Caps

Finally, WorldCom does not agree with the Notice's view that a pure price caps scheme will greatly diminish or even eliminate the need for strong accounting safeguards. Price caps may reduce some incentives to shift some costs, but certainly not all of them. Price caps also do nothing to prevent RBOC discrimination, which is another statutory mandate that requires strong and effective accounting safeguards. In addition, price caps will not govern the wholesale rates that the RBOCs charge their affiliates and other carriers under Sections 251 and 252 of the Act. Moreover, price caps do not affect the prices of affiliate transactions, or the RBOCs' incentives to shift costs to their regulated local exchange entity. Finally, price caps do not automatically make current RBOC rates reasonable, but rather only impose certain limits on the RBOCs' ability to increase rates for certain services. In short, the existence and strength of the FCC's nonstructural safeguards should not depend at all on the status of price caps.

TABLE OF CONTENTS

	<u>PAGE</u>
SUMMARY	i
I. GIVEN THE PERVASIVE MARKET POWER OF THE BELL OPERATING COMPANIES, THE COMMISSION MUST ADOPT SPECIFIC, CLEAR, AND COMPREHENSIVE NATIONAL RULES TO PROTECT CAPTIVE RATEPAYERS AND COMPETITORS FROM UNLAWFUL COST SHIFTING AND DISCRIMINATION	1
A. The Bell Companies' Existing Market Power Will Only Increase In The Foreseeable Future As Competitors Are Compelled To Depend More Heavily On Their Bottleneck Local Exchange And Exchange Access Facilities	1
B. The Commission Must Fashion Accounting Safeguards That Adhere To, Rather Than Undercut, The Strong Statutory Requirements	6
II. THE BELL COMPANIES' INTEGRATED OPERATIONS MUST ABIDE BY STRENGTHENED COST ALLOCATION RULES THAT WILL ENSURE THAT RATEPAYERS AND COMPETITORS ARE NOT SUBJECT TO UNLAWFUL DISCRIMINATION AND CROSS-SUBSIDIZATION	10
A. <u>General</u>	10
B. <u>Section 271 (InterLATA Telecommunications Services)</u>	
1. Integrated Provision of Out-of-Region InterLATA Services	11
2. Incidental InterLATA Services [<u>Notice</u> , paras. 37-38]	14
3. Other Issues [<u>Notice</u> , paras. 41-50]	15
a. Access charge imputation	15
b. Nondiscriminatory provision of service	16
c. FCC jurisdiction	17
C. <u>Section 276 (Payphone Services)</u>	18
III. THE BELL COMPANIES' SEPARATED OPERATIONS MUST BE REQUIRED TO ABIDE BY STRENGTHENED ACCOUNTING AND AFFILIATE TRANSACTION REQUIREMENTS THAT WILL ENSURE THAT RATEPAYERS AND COMPETITORS ARE NOT SUBJECT TO UNLAWFUL DISCRIMINATION AND CROSS-SUBSIDIZATION	20
A. <u>General</u>	20

B.	<u>Section 272</u>	21
1.	Accounting Requirements [<u>Notice</u> , paras. 67-69]	22
2.	"Arms Length" Requirements [<u>Notice</u> , paras. 70-88]	23
a.	Identical valuation methods for assets and services	25
b.	Prevailing company prices	25
c.	Estimates of FMV	26
d.	Tariff-based valuation	27
3.	Application to InterLATA Telecommunications Affiliates [<u>Notice</u> , paras. 89-90]	28
4.	Application to Joint Marketing [<u>Notice</u> , para. 91]	29
5.	Audit Requirements [<u>Notice</u> , paras. 92-94]	30
C.	<u>Separated Operations Under Section 271</u>	31
IV.	THE EXISTENCE AND STRENGTH OF THE COMMISSION'S NONSTRUCTURAL SAFEGUARDS SHOULD NOT DEPEND IN ANY WAY ON THE STATUS OF THE COMMISSION'S FLAWED PRICE CAPS REGIME	32
V.	CONCLUSION	33

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
)	
Implementation of the)	
Telecommunications Act of 1996;)	CC Docket No. 96-150
)	
Accounting Safeguards Under the)	
Telecommunications Act of 1996)	

COMMENTS OF LDDS WORLDCOM

WorldCom, Inc., d/b/a LDDS WorldCom ("WorldCom"), hereby files its comments in response to the Notice of Proposed Rulemaking ("Notice"), FCC 96-309, issued by the Commission on July 18, 1996 in the above-referenced proceeding. As one of the four largest facilities-based interexchange carriers ("IXCs") in the United States, WorldCom has a substantial interest in the outcome of this proceeding.

I. GIVEN THE PERVASIVE MARKET POWER OF THE BELL OPERATING COMPANIES, THE COMMISSION MUST ADOPT SPECIFIC, CLEAR, AND COMPREHENSIVE NATIONAL RULES TO PROTECT CAPTIVE RATEPAYERS AND COMPETITORS FROM UNLAWFUL COST SHIFTING AND DISCRIMINATION

A. The Bell Companies' Existing Market Power Will Only Increase In The Foreseeable Future As Competitors Are Compelled To Depend More Heavily On Their Bottleneck Local Exchange And Exchange Access Facilities

The Telecommunications Act of 1996 Act¹ is a milestone achievement in the long and still unfinished road leading from entrenched monopoly to unfettered competition. While

¹ The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act").

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

holding to the belief that true competition in the local exchange can and will become a lasting reality at some point in the future, Congress clearly intended that the Commission establish specific, clear, and comprehensive rules to protect ratepayers and competitors from unlawful cost-shifting and discrimination by the Regional Bell Operating Companies ("RBOCs") as they begin to vertically reintegrate and provide currently-competitive services such as long distance service. In tacit recognition of the all-pervasive market power still enjoyed exclusively by the incumbent RBOCs, the Act requires a separate affiliate for RBOC provision of certain activities, including in-region interLATA service, as well as various transactional and accounting safeguards to ensure that the RBOCs cannot abuse their monopoly position.²

In CC Docket No. 96-149, the Commission is considering the specific structural separation requirements applicable to the RBOCs, as well as the regulatory classification of the competitive services to be provided by the RBOCs.³ In its comments in that proceeding, WorldCom identified four principles, drawn from market realities, that should guide the Commission as it fashions its safeguards: (1) competitors' dependence on RBOC networks is increasing; (2) RBOC discrimination in either exchange access or local service inputs can prevent competition in all telecommunications services; (3) new local networks will not reduce

² 1996 Act, Section 272.

³ Implementation of the Non-Accounting Safeguards of Section 271 and 271 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, Notice of Proposed Rulemaking, FCC 96-308, released July 18, 1996 ("Non-Accounting Safeguards Notice").

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

RBOC market power anytime soon; and (4) deregulation of RBOC pricing is premature while safeguards are still untested and RBOC incentives and ability to discriminate are increasing. WorldCom showed how these principles lead to the conclusion that strong structural and nondiscrimination safeguards must be put in place to protect consumers from RBOC cross-subsidization and supracompetitive pricing, as well as to prevent discrimination in the pricing and provisioning of inputs required by the RBOCs' local and long distance service competitors. Dominant carrier status is also essential for the RBOCs' interLATA activities, especially while the sufficiency of structural separation and other safeguards is being tested.⁴

Those same principles should be applied in this proceeding as well. In particular, a firm understanding of the source of the RBOCs' market power is vital to the proper fashioning of accounting safeguards designed to curb the discriminatory exercise of that power. The FCC's seminal Competitive Carrier Order defined market power as "the control a firm can exercise in setting the price of its output," and otherwise acting in a manner that "may be anticompetitive or otherwise inconsistent with the public interest."⁵ The Competitive Carrier Order discussed how market power allows an entity to set prices either above or below competitive costs.⁶ While the Commission recently has tended to focus on that particular element of the market

⁴ See Comments of LDDS WorldCom, CC Docket No. 96-149, filed August 15, 1996, at 3-4.

⁵ Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1, 21 (1980) ("Competitive Carrier Order").

⁶ Id.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

power definition,⁷ the Competitive Carrier decisions actually stand for much more than that.

As the Commission first held in 1980:

An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities. A firm controlling bottleneck facilities has the ability to impede access of its competitors to those facilities. We must be in a position to contend with this type of potential abuse. We treat control of bottleneck facilities as prima facie evidence of market power requiring detailed regulatory scrutiny.⁸

Referring to a long string of antitrust cases and law texts, the Commission concluded in the Competitive Carrier Order that control of bottleneck facilities is present "when a firm or group of firms has sufficient command over some essential commodity or facility in its industry or trade to be able to impede new entrants."⁹

The applicability of this "bottleneck facilities" test is especially compelling in the context of the new pro-competition paradigm created by the Telecommunications Act. In particular, the Act for the first time allows competitors to contest the RBOCs in their local exchange markets, either by utilizing portions of the RBOCs' local exchange network (via unbundled network elements) or by reselling the RBOCs' retail services. Both avenues of competitive entry necessarily require total dependence on at least some essential parts of the

⁷ See, e.g., Non-Accounting Safeguards Notice at paras. 13-16 (Market power is the ability to raise prices by restricting output, or engaging in a "price squeeze" against competitors).

⁸ Competitive Carrier Order at 21 (citation omitted, emphasis supplied).

⁹ Id. (citation omitted).

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

RBOC network in order to provide local service. Thus, ironically, the very act of competing head-on with the RBOCs creates a heightened degree of reliance on the RBOCs' bottleneck facilities that did not exist before. When combined with the RBOCs' eventual advent into the long distance market -- while they still possess bottleneck control over necessary local facilities -- it is clear that the RBOCs' prima facie possession of market power in both the local exchange and exchange access markets will, if anything, increase in depth and range over the near term.¹⁰ As the FCC found in 1980, there is a consequent need for the Commission to engage in "detailed regulatory scrutiny" of the entities possessing such pervasive market power. The Commission must be mindful of these facts, both in this proceeding and in CC Docket No. 96-149, as it prepares to adopt the only public interest safeguards that will stand between the RBOCs and their increased incentive and ability to wield their market power in discriminatory and anticompetitive ways. Nonetheless, to the extent that effective local competition -- both retail and wholesale -- begins to develop many years down the road, and the RBOCs' market power consequently begins to erode, WorldCom believes that the Commission will be able to curtail, if not eliminate completely, many of the required accounting safeguards it must now adopt in this proceeding.

¹⁰ See Comments of LDDS WorldCom, CC Docket No. 96-145, at 3-10. Those comments are incorporated by reference herein.

**B. The Commission Must Fashion Accounting Safeguards That Adhere To,
Rather Than Undercut, The Strong Statutory Requirements**

[Notice, paras. 5-16]

The Notice states that the purpose of this proceeding is to implement provisions of the Telecommunications Act "to establish accounting safeguards to constrain potential cost misallocation and discrimination against competitors."¹¹ The Commission acknowledges that these safeguards are necessary in order to combat the RBOCs' pervasive market power. For example, the Commission notes that the RBOCs currently have a 99.5% market share for local exchange and exchange access services, and that in many instances incumbent LECs have an incentive to misallocate costs to their regulated business that should be allocated to their competitive ventures.¹² To constrain this ability and incentive to commit anticompetitive acts, the Commission notes that the Act prescribes a "judicious mix" of structural and non-structural safeguards to protect ratepayers, consumers, and competitors against cost misallocation and discrimination.¹³

While WorldCom firmly agrees with each of these well-supported observations, it is troubling that the Notice goes on to assert several tentative positions that appear to undercut many of these very same observations. First, the Commission refers repeatedly to the need to enact rules that preserve the "potential competitive benefits" of the RBOCs' "legitimate

¹¹ Notice at para. 6.

¹² Notice at para. 6.

¹³ Notice at para. 6.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

economies of scope," so that the RBOCs can "realize their reasonable competitive advantages."¹⁴ In its open approval of these so-called "economies of scope," the Commission nowhere supplies a supporting reference to any provision of the Telecommunications Act, or the legislative history, that allows this highly dubious rationale to infect the rulemaking process. Moreover, what the Commission labels "legitimate economies of scope" in this proceeding historically has been viewed as the ill-gotten byproduct of monopoly power. Indeed, these statements in the Notice are directly contradicted by statements in the FCC's recent Local Interconnection Order, where the Commission observes that the RBOCs' "economies of density, connectivity, and scale... traditionally... have been viewed as creating a natural monopoly."¹⁵

The Commission there continues:

[T]he local competition provisions of the Act require that these economies be shared with [new local market] entrants. We believe they should be shared in a way that permits the incumbent LECs to maintain operating efficiency to further fair competition, and to enable the entrants to share the economic benefits of that efficiency in the form of cost-based pricing.¹⁶

Thus, rather than allowing the RBOCs to wield their monopoly-derived "efficiencies" abusively and exclusively in the market, the Commission has already indicated that the Act requires the RBOCs to share those efficiencies with new entrants in the form of cost-based interconnection

¹⁴ Notice at paras. 7, 9, 10.

¹⁵ Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, issued August 8, 1996, at para. 11.

¹⁶ Id.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

prices. Unless the Commission can supply a compelling statutory basis for the Notice's very different view of the RBOCs' "economies of scope," its rules cannot and should not lawfully reflect that view.

The Commission also indicates in the Notice that it seeks "to minimize the burden our rules impose upon those subject to them...."¹⁷ Again, this is not an explicit dictate, or even principle, of Sections 271 or 272 of the Act.¹⁸ Especially when the Commission is attempting to craft initial cost allocation rules to govern the RBOCs' opening forays into the competitive telecommunications market, any misplaced concern about minimizing the supposed burdens of these rules on the regulated entities must be outweighed by the public interest need to get the rules right from the outset.

Third, the Commission expresses general satisfaction with its existing Part 32 rules (affiliate transactions) and Part 64 rules (cost allocation and accounting), and tentatively concludes that these rules, modified in some respects, best meet the statutory requirements.¹⁹ While many parties, including WorldCom, may agree with at least some aspects of that statement, the Notice then goes much further to assert that those parties urging a more detailed,

¹⁷ Notice at para. 8.

¹⁸ Of course, Section 401 of the Act gives the Commission authority to forbear from applying certain statutory provisions to telecommunications carriers, provided several tests are met. 1996 Act, Section 401(a). However, the Commission cannot simply exercise that authority, at least with regards to Section 271, without first "fully implementing" the regulations that are proposed for forbearance. 1996 Act, Section 401(d).

¹⁹ Notice at para. 11.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

stronger set of accounting safeguards "bear a heavy burden of persuading us to adopt such safeguards."²⁰ This is plainly wrong. The Act nowhere imposes such an elevated burden on only nondominant parties to this proceeding. Rather than creating insurmountable proof standards out of thin cloth, the Commission should focus its energies instead on fashioning rules that do precisely what the Act requires -- prevent the anticompetitive exercise of market power by the RBOCs.

Finally, the Commission's Notice on its face only considers what safeguards should apply to the RBOCs' structurally separated in-region operations, and to both their separated and integrated out-of-region operations. A related crucial issue -- what conditions to impose on the RBOCs' in-region operations once the statutorily-mandated separate subsidiary requirement has been eliminated -- is not raised directly by the Commission. WorldCom urges the Commission to resist expected efforts by the RBOCs to try to define in this proceeding the exact parameters of those conditions for in-region interLATA services. Such an exercise would be woefully premature. The actual removal of the separate subsidiary requirement is at least three years away for any one RBOC, if not much longer, and the Commission must use the intervening time wisely to determine which of its safeguards work, and which ones must be strengthened for future in-region application. This proceeding should only focus on the here-and-now questions that are necessarily posed by the 1996 Act.

²⁰ Notice at para. 12.

II. THE BELL COMPANIES' INTEGRATED OPERATIONS MUST ABIDE BY STRENGTHENED COST ALLOCATION RULES THAT WILL ENSURE THAT RATEPAYERS AND COMPETITORS ARE NOT SUBJECT TO UNLAWFUL DISCRIMINATION AND CROSS-SUBSIDIZATION

A. General

[Notice, paras. 27-28]

The Commission tentatively concludes that its existing Part 64 cost allocation rules "generally satisfy the statute's requirements of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services."²¹ The Commission also expresses concern about adopting a fundamentally different cost allocation approach that "might impose substantial administrative and financial costs on the carriers."²²

As indicated above, WorldCom does not believe the Commission can carry out its statutory duties by simply reaffirming the adequacy of its current rules. Among other things, the rules adopted in the past to separate the RBOCs' regulated and nonregulated services were designed for other markets, such as enhanced services. The full-service telecommunications market that is emerging today presents a far different picture, one in which competing entities will vie with one another to provide a multitude of one-stop shopping packages to consumers. In such a competitive environment, even small differences in price and quality of service that are detectable by consumers can translate into huge differences in market success. Where the RBOCs possess the ability to use their market power to manipulate the end result in several

²¹ Notice at para. 27.

²² Notice at para. 28.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

telecommunications markets at once, consumers lose the chance to experience true, market-based competition free of discriminatory effects. The Commission's role under the new Act is to make sure that this scenario never becomes reality, and that captive ratepayers and competitors do not unknowingly and unwillingly help subsidize the RBOCs' competitive ventures.

In addition, the Commission's stated considerations about additional costs the RBOCs might incur to comply with stronger safeguards are misplaced and find no support in the text of the Act. The Commission's focus must at all times be on the public interest, not on reducing certain companies' costs of complying with statutory mandates.

Moreover, as mentioned above, the question of what safeguards to apply to the RBOCs' integrated provision of in-region interLATA service and local exchange and access service is premature and need not be considered here. To the extent the RBOCs attempt to raise this issue, the Commission should defer consideration until it is presented in the context of an actual RBOC application to provide in-region interLATA services on an integrated basis.

B. Section 271 (InterLATA Telecommunications Services)

[Notice, paras. 37-61]

1. Integrated Provision of Out-of-Region InterLATA Services [Notice, paras. 39-40]

Section 271(b)(2) of the 1996 Act allows the RBOCs to provide out-of-region

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

interLATA services upon enactment of the Act.²³ However, the Act does not specify whether those out-of-region services must be provided via a separate affiliate. In a recent decision, the Commission concluded that the RBOCs are authorized to provide their out-of-region services on an integrated basis with their local exchange services, so long as those services are classified as dominant.²⁴

In the Notice, the FCC proposes to apply its cost allocation rules to the RBOCs' provision of out-of-region interLATA services and local exchange and access services on an integrated basis. Two possible methods are mentioned: establishing a separate category of regulated interLATA services (as was the case with video dialtone service), or allocating interLATA service costs to the nonregulated category (as is now the case for the RBOCs' out-of-region interLATA service).²⁵

WorldCom strongly supports the application of the FCC's cost allocation rules, including the Uniform System of Accounts ("USOA") prescribed by Part 32 of the FCC's Rules, to the dominant RBOCs and their affiliates. Specifically, the RBOCs must apply the USOA to

²³ 1996 Act, Section 271(b)(2).

²⁴ Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, Report and Order, FCC 96-288, released July 1, 1996 ("RBOC Out-of-Region Order"). LDDS WorldCom filed reply comments in that proceeding generally supporting the Commission's proposal, but urging stronger structural separation and cost accounting safeguards applicable to the RBOCs' out-of-region interLATA operations. See Reply Comments of LDDS WorldCom, CC Docket No. 96-21, filed March 25, 1996.

²⁵ Notice at para. 39.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

their integrated provision of out-of-region interLATA services and local exchange and access services. To accomplish this, the Commission should allocate out-of-region interLATA service costs to a wholly separate account within the nonregulated category for accounting purposes only. As the FCC found in the RBOC Out-of-Region Order, "[t]he fact that interLATA services are regulated services in and of itself does not eliminate the potential for cost misallocation between the BOCs competitive (interLATA) and noncompetitive (local exchange and exchange access) services."²⁶ In that order, the FCC directed the RBOCs to treat their interLATA services affiliate as nonregulated in order to "minimize the possibility that a BOC could improperly shift the costs of its interstate, interexchange operations to its regulated local exchange and exchange access ratepayers."²⁷ That threat is far more serious where the RBOCs can provide interLATA services and local exchange and exchange services on an integrated basis, and where the RBOCs' primary incentive will be to use their local monopoly assets to unfairly advantage their long distance operations.

In contrast, the other option presented by the Commission, a separate category within the regulated account, should not be adopted. While such a mechanism would more closely match the current regulated status of interexchange services, the potential for RBOC misallocation of costs between two categories in a regulated account is far greater than between a regulated account and a nonregulated account. In order to adequately protect ratepayers,

²⁶ RBOC Out-of-Region Order at para. 39.

²⁷ Id.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

consumers, and competition, the Commission should require that the RBOCs treat their integrated interLATA services as nonregulated for cost allocation purposes.

2. Incidental InterLATA Services [Notice, paras. 37-38]

Section 271(g) of the Telecommunications Act lists specific "incidental" interLATA services that the RBOCs are able to provide upon enactment of the Act.²⁸ Section 271(h) states that the FCC "shall ensure" that the RBOCs' provision of these incidental services "will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."²⁹ The FCC seeks comments on whether its present Part 64 rules are "adequate" to satisfy the dictates of Section 271(h).³⁰

WorldCom believes that the language of Section 271(h) strongly implies that the FCC's current rules are not adequate to ensure that the RBOCs' provision of incidental interLATA services do not adversely affect ratepayers and competitors. Simply readopting current rules is a far cry from actively "ensur[ing]" that the RBOCs will not create any negative impact when they provide incidental services. At a minimum, the Commission should apply the same cost allocation requirements to the RBOCs' incidental services that are applied to their other interLATA services.

²⁸ 1996 Act, Section 271(g).

²⁹ 1996 Act, Section 271(h).

³⁰ Notice at para. 38.

3. Other Issues [Notice, paras. 41-50]

a. Access charge imputation

Section 272(e)(3) of the Act requires the RBOCs to impute access charges to themselves.³¹ The Notice seeks comments on precisely how these access charges should be imputed. The Commission suggests that one approach would be for these charges to be recorded by the RBOCs as expenses directly assigned to nonregulated activities, with a corresponding credit to the regulated exchange access revenue account.³²

WorldCom agrees with the Commission's suggested means of imputing the RBOCs' access charge revenues. However, this simple accounting exercise, in and of itself, is not nearly enough. As WorldCom pointed out in its comments in CC Docket No. 96-149, there are several ways the RBOCs can still discriminate against competitors.³³ Even with imputation in place, there is no way under price cap regulation to ensure that all the RBOCs' other costs of providing interLATA service are fully reflected in the retail prices of the RBOC affiliate's interLATA services. An RBOC can also evade an imputation requirement by passing on its access cost savings in reduced retail prices for other components of a full-service package, such as local exchange service. For this reason, the Commission must ensure that the full price of access, plus a reasonable amount of overhead costs, is included in the retail rates the RBOCs

³¹ 1996 Act, Section 272(e)(3).

³² Notice at para. 41.

³³ Comments of LDDS WorldCom, CC Docket No. 96-149, at 23-25.

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

will charge to consumers, so that those rates are not artificially set below the actual cost of access.

Moreover, the Commission must take several additional steps to ensure that the access imputation rule itself is fully enforced. First, the independent audit that is required by Section 272(d) should include a detailed examination of the RBOCs' methods of access imputation to ensure that all transactions are properly handled.³⁴ Second, the Commission itself must examine the RBOCs' records periodically to determine whether the RBOCs are assigning the proper access amounts, no more and no less, to themselves. Third, because access imputation is a clear and explicit statutory requirement, the Commission should adopt a rule provision authorizing serious penalties, up to and including revocation of interLATA authority, for any demonstrated violation of the requirement.

b. Nondiscriminatory provision of service

Section 272(e)(4) of the Act allows the RBOCs to provide intraLATA or interLATA services to their interLATA affiliates only if (1) the services are made available to all other carriers on the same terms and conditions, and (2) the costs are properly allocated.³⁵ The FCC seeks comments on what cost allocation rules to adopt to implement this provision.³⁶

WorldCom believes that the Commission should adopt a general rule that mirrors

³⁴ See 1996 Act, Section 272(d).

³⁵ 1996 Act, Section 272(e)(4).

³⁶ Notice at para. 42.